RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Sept. 4, 1991 **LETTER 1077**

Aug. 23 DJIA 3040.25; PTI 3369; A-D Ratio -10.53
Aug. 29 DJIA 3049.64; PTI 3373; A-D Ratio -10.37
Dow Yield: 3.0%; Dow P/E: 23.3; DowPow: 83
Dow 200-day MA: 2846; Dow 30-day MA: 2999
Dow Book Value: 1331; PTI 89-day MA: 3310
Percentage of Undervalued Blue-chips: 11%
Summation Index: 1835

THE MARKET: After six months of being locked in a tedious trading range, the majority of averages (during August) pushed out of their trading ranges to close at new highs. Only the Dow hesitated. But on August 23, the D-J Industrial Average finally followed the lead of the major composite averages to close at a new high of its own -- above the previous Dow record high of 3035.33.

The rise was not without a good deal of technical support. The Summation Index rose to a new high on August 28 as did my Primary Trend Index (PTI) (see below). The 30-day moving average of the Dow is now at 2999, well above the rising 200-day MA of the Dow, which stands at 2846. On August 28, the Advance-Decline Ratio joined the upside parade, climbing to a new 1991 high.

If there is a single fly in the ointment, it's the divergent action of the D-J Transportation Average (see chart below). On June 4, the Transports recorded a peak of 1251.76. Two months later, on August 1, the Transports recorded a lower peak of 1225.84. Most recently, on August 23, the Transports recorded a still lower peak of 1215.44.

Thus we have a series of new record highs in the Dow against a series of declining tops in the Transports. This is a situation which almost nobody has noticed, but it presents a potentially dangerous situation from a Dow Theory standpoint (of course, the "all clear" signal would be given if Transports were to rally above their 1251.76 peak). It is well to remember that the Transports reflect the nation's sales, shipping and travel capabilities.

One other area has me wondering. Where are the daily new highs? On February 12 my five-day average of daily new highs (NYSE) recorded a 1991 peak of 162. The index hit 162 again on April 18. Currently, with the Dow at new record highs the 5-day MA is at 106. A rising number of new highs reflects healthy upside momentum. Declining new highs suggest a loss of participation and momentum.

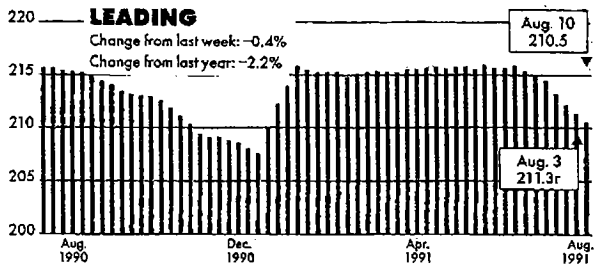
My Primary Trend Index (which measures the forces of underlying technical strength or weakness) has remained on a bullish path all along, and last week it again rallied to new highs.

The chart on page 2 offers an interesting example of the Dow moving sideways within its trading range, while the PTI marched steadily higher. Thus, the PTI was saying that even though the entire stock market appeared to be on "hold," internal forces were building upside pressure, pressure which would ultimately force the major averages out of the trading range to the upside.

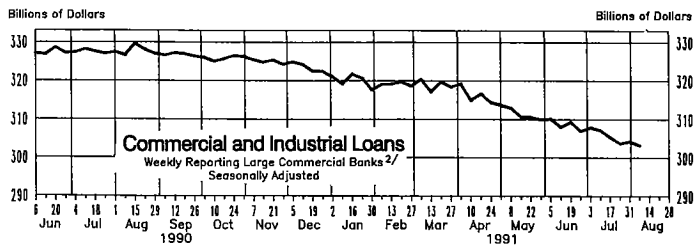
So on the plus side for this market we have new record highs in the Dow, the S&P 500, the NYSE Composite, the NYSE Financial Index, the Wilshire, the A-D ratio and the PTI -- all very important indices.

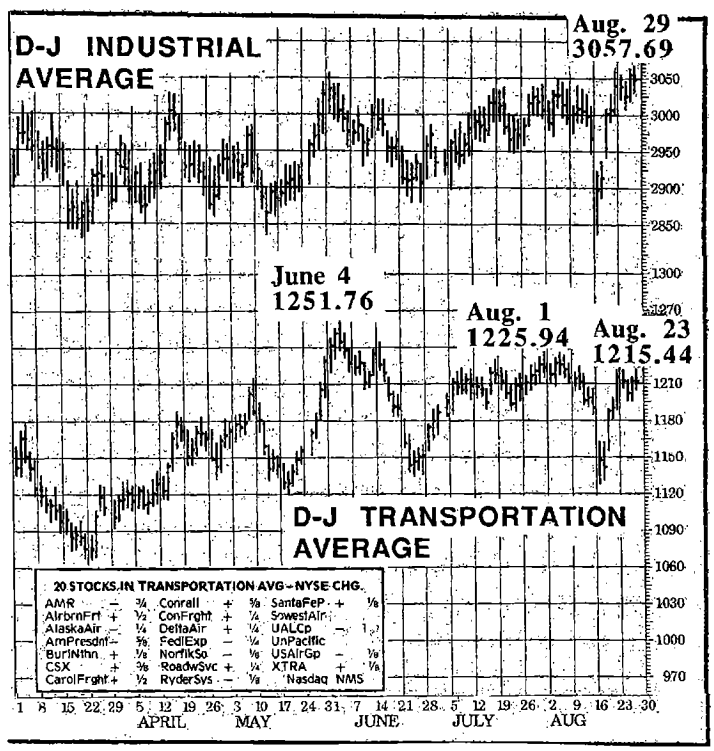
On the minus side we have the D-J Transports refusing to confirm. And we have the problem of overvaluation, a problem which has been outlined and stressed in recent Letters.

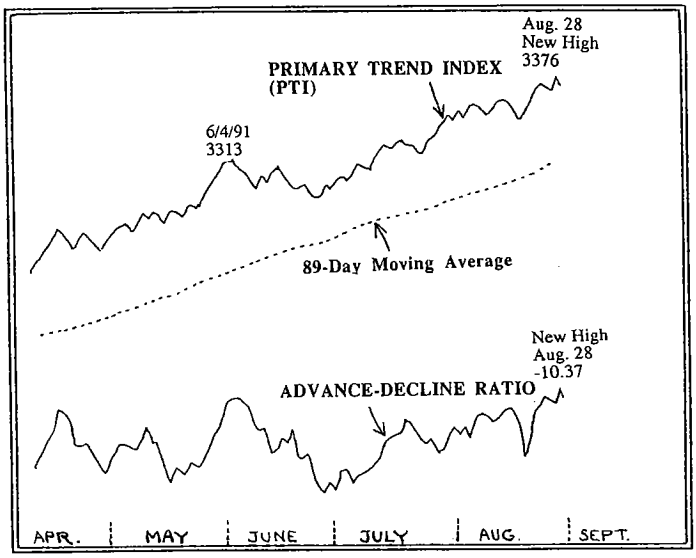
ECONOMICS: While the stock market continues on its upward path, there are few signs that the economy is ready to follow. So while we are receiving a steady diet of "happy predictions" out of Washington, the so-called "improvement in the economy" is far less obvious in the statistics. In fact the split between the market and the leading indicators is becoming dramatic. This is *Business Week's* latest chart of its leading economic indicators index. This index has been declining since late-June.



This chart is from the St. Louis Federal Reserve. It shows the trend of commercial and industrial loans going back to June 1990. If loans continue to drop, the money supply will also continue to drop. It's not a pretty chart.





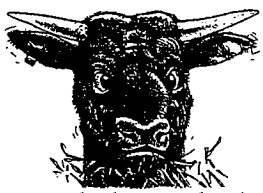


In their "Weekly Economic Data," Ed Hyman (*International Strategy and Investment*) presents a list of unusual items, and I mean they are <u>really unusual.</u> Here they are. Study them.

1. **Employment, the Workweek, and Average Hourly Earnings all 3 declined in July.** — **Only time on record.**
2. **Personal Interest Income growth.** — **Lowest on record.**
3. **Labor Force growth.** — **Lowest in 30 years.**
4. **Service Sector Employment growth.** — **Lowest on record.**
5. **Private Debt growth.** — **Lowest on record.**
6. **Nominal Personal Income growth.** — **Lowest in 30 years.**
7. **M2 growth.** — **Lowest in 30 years.**
8. **Japan's M2 growth.** — **Lowest on record.**
9. **Total Debt as a % of GNP.** — **Highest since the depression.**
10. **Business Failures as a % of GNP.** — **Highest on record.**
11. **Bank Loans + Commercial Paper growth.** — **Lowest ever.**
12. **The Effective Tax Rate for 1991:2Q.** — **Highest on record.**
13. **The Purchasing Managers' Price Index.** — **Lowest on record.**
14. **Bank + S&L Financial Assets growth.** — **Lowest on record.**
15. **Nominal Construction Spending growth.** — **Lowest on record.**

THE WORLD: <u>Primary movements are almost always international in scope</u>, and for that reason I am always interested in what David Fuller has to say (*Fuller Money,* 7 Swallow St., London WIR 7HD, UK). "Only five of the 25 stock markets that I follow most closely struggled (the operative word) to new mini-bull highs during the first half of August. That is the lowest tally in a progressively slowing trend since the January-February romp carried everything higher. The five new highs for August to date were - Australia, Denmark, Hong Kong, S. Africa and the UK. Last month I listed nine stock markets that had fallen by anywhere from 11% to 28% below their mini-bull market highs, adding that it was unusual for markets to fall 15% or more and then resume their upward trend to any significant degree."

INVESTMENT POSITION: Ferdinand, the cowardly bull,is still in the box. He's got a case of the "overvaluation shakes."



The overvaluation in this market continues to bother me, but let's face it -- no one knows at exactly what point "hot" becomes "too hot." *IQ Trends'* "Percentage of Undervalued Blue-Chip Stocks" has dropped to a very low (and risky) 11%. On August 28 the yield on the Dow sank to an equally risky 2.9%.

If you adhere strictly to the technical approach, I suppose you can justify staying with stocks, at least as long as the PTI maintains its stubborn upward path. If you're a value investor or a nervous investor (and anytime the Dow yields <u>under 3%,</u> as now, I'm nervous), the place to be is in T-bills or two-year Treasury notes. Six month German government paper is now yielding 9%. That's pretty attractive, almost 4% better than the same maturities in US government paper. Furthermore, the dollar looks toppy to me.

I don't know about my fellow letter writers, but I really hesitate to advise my subscribers to do what I'm not doing. What am I doing? I'm heavily in short-term government paper, and because I live in high-tax California, I'm also heavily in short-term state of California notes. Is the Dow going to 3500, 4000, 5000? Is the Dow yield going to 2.5%, 2.3%, 2.0%? If so, I guess I'll have to watch the show.

CYCLES? With the latest drop (August 7) in the Fed Funds rate to 5.5%, it is clear that the Fed harbors increasing doubts about the strength, or even the existence, of the so-called "recovery from recession."

The fact is that the Fed has been fighting the recession via lowered bank reserves and lower interest rates ever since last October when they cut the Fed Funds by 1/4%. They cut Fed Funds another 1/4% in November, and another 1/4% in December. In December, for the first time in seven years, the Fed cut bank reserve requirements. In January the Fed cut Fed Funds, again by 1/4%. In February they cut the discount rate by 1/2% (the second cut) and Fed Funds by a full 1/2%. In March they cut Fed funds another 1/4%, bringing them down to 6%. In April the discount rate was cut for the third time, a full 1/2% to 5.5%. Then on August 6 the Fed Funds were cut again by 1/4%, bringing them down to 5.25%. Now I'd say that the Fed was fighting the recession, wouldn't you?

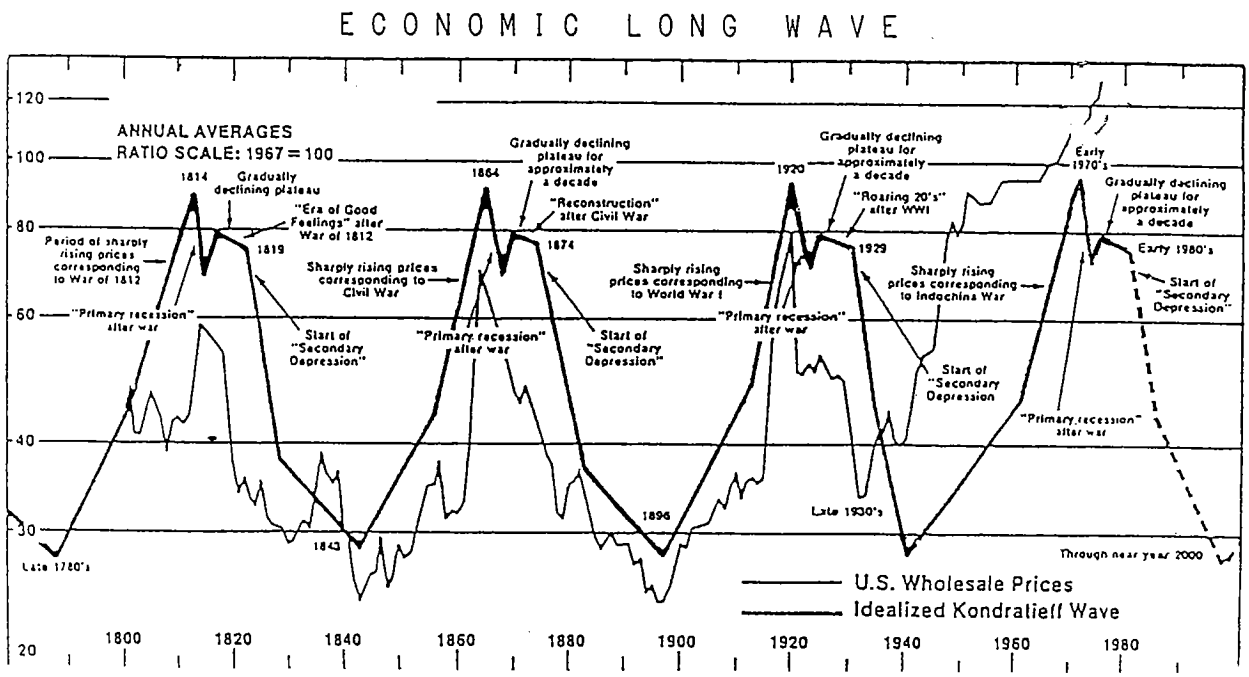
So what's happened? After all this manipulation by the Fed, long rates are still around 8%, business is still sluggish, and many observers (and a great many businessmen) maintain that the nation is still in recession (although Administration economists, of course, disagree).

Is something wrong? Has the Fed lost its ability to manipulate the trend of the economy? Or more ominous, is the nation caught in the grip of the downside of the great Kondratieff Wave? Caught? That's exactly what followers of the Long Wave Theory believe. According to the Kondratieff Wave theory, the "economic long wave" follows roughly a 50-60 year cycle. The accompanying chart (page 3) portrays the world according to followers of Kondratieff.

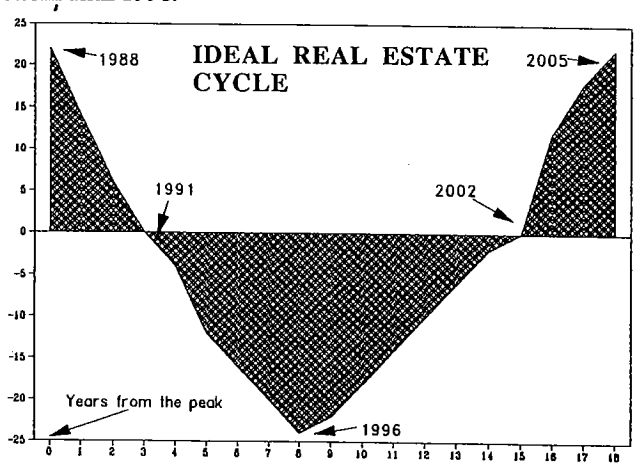
At the beginning of the Kondratieff cycle commodity prices turn up and business starts to improve. What follows is a period of around 25-30 years of general prosperity, rising prices, and "good feelings." Finally the top arrives, and for a period of a few years things become rocky, and there are many unpleasant surprises in the economy and in the markets. Next, there is a "plateau period" of around ten years duration. During this period (corresponding to the "Reconstruction Period" following the Civil War, the "Roaring '20s and the debt-crazed '80s) inflation is rampant and a false or deceptive recovery materializes.

Following the Plateau the economy slides into that black period known as the "secondary depression." This is the "wipe out" era, a period of deflation, declining prices, bankruptcies and crises. According to followers of Kondratieff, we are currently moving into the period of the big downer, the secondary depression era.

The so-called long wave is considered to be the most powerful and important of all the cycles. The second most important cycle is the 18-year cycle, often termed the "real estate cycle." Don Hoppe writes about this in his latest report (*Kondratieff Wave Analyst,* Box 977, Crystal Lake, IL 60014). Hoppe also includes this chart



(below), which recently appeared in *Cycles* magazine. The chart shows the idealized Real Estate Cycle, a cycle that topped out in 1988, then turned negative in 1991, and is not slated to reach bottom until 1996.



In his report Hoppe notes the similarity of the real estate down-cycles of the 1920s and the 1980s. First there was the farmland decline (1915 to 1920 and most recently 1975 to 1980). Next came the decline of resort properties (1922-25 corresponding to 1982-85). Then came the demise of suburban properties (1922-28 and in 1982-88). Finally, there was the collapse of commercial real estate during 1922-30 and currently during 1982-90. Writes Hoppe, "What is absolutely certain now is that all real estate sectors have peaked and all are now in bear markets. Furthermore, the bear markets are only in their early stages, despite price erosions already ranging from moderate to severe. And finally, there is literally no possibility at all of an early recovery in either prices or building activity, because of the huge amount of excess space overhanging the market and because of demographic and other forces that will result in declining demand for years to come."

It is obvious that Don Hoppe sincerely believes in the Kondratieff Wave thesis. What do I think? Personally, I go more by the action of the stock market and the economy. I know there is a real estate cycle, and to me it is obvious that the up-cycle has ended and that real estate is in for a possible extended period of decline and digestion. I grew up during the Depression, and I saw the unbelievable depths to which real estate can fall.

I'll give you an example which sticks in my mind. In 1942 my father (who was a real estate man all his life) wanted to buy the Whelan Hotel in NYC. It was a fine hotel situated on the East Side. To buy it my father needed to raise $125,000 in cash. But the fact is that back in 1942 he just couldn't raise the money. Nobody in 1942 would have anything to do with real estate or my father's deal, despite the fact that the bar alone at the Whelan netted over $125,000. People who had money in 1942 didn't want to invest in anything, much less NYC real estate. Cash was King, absolute King. If you were lucky enough to have any cash, you didn't let it go -- no matter what the deal was.

I hope we never see times as tough as those again. But economic cycles have a way of running from one extreme to the other. During the '30s and '40s, as I said, the dollar was king. The only problem was that nobody had dollars. Today there are plenty of dollars around. The problem is that knowledgeable investors have serious reservations about the future of the dollar itself.

At any rate, if there is any validity in Kondratieff and in the Real Estate Cycle we can expect the 1990s to be a very difficult decade. And we can expect real estate weakness to continue to at least 1996 and perhaps beyond. But when we consider that real estate prices have been rising from the end of WWII to the late 1980s, it should come as no shock to realize that a period of adjustment is overdue.

I've thought a good deal about cycles. One of the objections to cycle theory (or practice) is that just when you "need" a given cycle, it doesn't seem to materialize. Another objection is that cycles always seem most "obvious" in retrospect. A third objection is that there are a great many cycles, and while one longer cycle may be pointing up, two or three smaller cycles (acting within the larger cycle) may be pointing down. Thus, a cycle theorist may be able to explain any movement simply on the basis of which cycle he thinks is dominant at the time.

Cycle theorists hold that cycles are "preordained," that they are a natural phenomenon. As such, they exist regardless of man's efforts to eliminate them. And, of course, herein lies the main resistance to cycle theory. Man (and particularly economists) like to think that they can control the economy -- if only they can push the right buttons. Thus, the cycle argument goes on. And the biggest test, the validity of the Kondratieff thesis, is now upon us.

NOTES & QUOTES: Last week I spoke at the ISI seminars in both Vancouver and San Francisco. At SF I asked an audience of 350 people, "How many of you, based on your own experience, think that the recession is over?" About five people raised their hands. Maybe that's just California, where the latest figures show that home sales plunged 9.7% in July. Obviously, people are not

finding matters particularly rosy in their own economic lives . . . Vancouver is a big, beautiful city (1.3 million pop.). The first thing we noticed upon arriving in Vancouver was that the streets are spotlessly clean, unlike big US cities. We also felt safe in Vancouver, even walking about at night. I asked Faye about the difference. She answered, "The big US cities feel menacing. You never feel safe at night and that goes for a lot of places during the day." Since we were in Vancouver last (six years ago) the city has grown tremendously -- many beautiful new buildings, many plush shopping malls. There's been a huge influx of Asians, particularly from Hong Kong. And they have brought money -- billions of dollars worth, and the wealth is obvious everywhere in Vancouver. Vancouver has a huge Chinatown (second largest in N. America), and being a big fan of Chinese food -- well, you know the rest . . .

* *

Quote of the Week (from Paul Roberts in *Business Week* -- Sept. 2): "Even with a tax hike and a defense meltdown, Bush has produced a bigger deficit than Reagan did with a tax cut and a military buildup. Darman has doubled his deficit projection, showing the budget deal was a fraud . . . Darman had to raise the 1992 deficit estimate to $348 billion, a new record. So much for the infamous Bush tax increase that was supposed to guarantee a lower deficit."

* *

What killed the ill-fated hardliners' Soviet coup? The same thing that brought Gorbachev into power, and the same thing that spelled the beginning of the end for Communism -- communications. Western ideas and technology have swept through the Soviet Union, from FAX machines to computer bulletin boards to alternative radio stations. Army troops stationed outside the Russian parliament building during the coup were listening to the latest BBC and Radio Liberty broadcasts. That, plus Yeltsin and a Russian public that "was mad as hell and wasn't going to take it any longer," were what destroyed the coup. The truth destroyed Communism, and today the truth can be communicated across the world via electronics.

* *

The Soviets owe the West roughly $60 billion, about $30 billion of which is owed to Germany. Will it ever be paid back? My guess -- never.

* *

I guess I'm dense, but I still fail to see why George Bush is a popular president. First, he picks a vice president who nobody takes seriously. Then he starts a war in the Mideast and pulls out before it's finished. Next he backs Gorbachev to the hilt while snubbing Yeltsin, even after it is painfully obvious that Yeltsin is the future of Democracy and the free market in the Soviets. Then he warns the Baltic nations not to split from the Soviet Union, When it's obvious that this is the wrong path, Bush stalls on recognizing the Baltics, while the whole world is cheering wildly in their bid for freedom. I don't see where Bush has shown any great courage. I certainly don't see where he has shown any intuitiveness. I guess maybe he means well, and that's why he's popular. Oh yeah, he's against burning the flag, that's an important issue. But basically, I'm just not hot about George.

* *

Currently, the US spends a massive $300 billion a year on the military. The US is the single largest exporter of arms (mostly to the Mideast and currently mostly to Saudi Arabia). The fact is that Britain, France, Germany and Italy have reduced arms sales while the US expands its military sales. In 1991, the US will give or sell $41 billion in arms to foreign nations.

* *

Every investor looks for that "pot of gold," the guaranteed sure thing. One of the widely-advertised sure things tells us that the "market always goes up during presidential years." I checked my D-J chart albums and found that it ain't necessarily so. Presidential years in which the market was down were 1932, 1940, 1948, 1960 and 1964. Conclusion: "There is no sure thing where the stock market is concerned." The corollary -- "The stock market can do anything."

* *

Natalie Cole, daughter of Nat King Cole, has brought out a new album ("Unforgettable"), an album in which she sings a number of her father's hit songs, and through the marvel of electronics her voice is dubbed over her father's. The album has been a surprising huge success. And it brings back memories of my high school days. Back in 1940-42 New York's 52nd Street was a jazz Mecca. East of Seventh Avenue on 52nd one could find a collection of jazz clubs, and my favorite was Kelly's Stables. There one could see many of the greats, although at the time few people realized they were seeing jazz history. The house band at Kelly's was the King Cole Trio. Nightly one could hear Nat King Cole playing piano along with his guitar player and drummer. In those days Cole never sang, he was strictly a pianist. And few people paid attention to him or his trio.

The price I paid for listening to the greats -- Lester Young or Coleman Hawkins or Roy Eldridge, was 60 cents for a coke (there was no cover charge at the bar). I would go there with a few buddies and spend the whole night nursing a single coke. Of course, the bartender wasn't thrilled with us, but we were only sixteen or seventeen. Maybe the bartender had kids of his own, so he would give us an occasional annoyed look -- then tend to his paying customers.

The highlight of those times occurred when I went to Kelly's Stables with Don Wolf, an upper classman from high school. Don was a rabid jazz fan, and a friend of Billy Holiday. He also had enough money (a miracle) to afford a table at Kelly's. After singing her set, Billy would sit down with us and have a rum cola and talk. I was a big Holiday fan, but, of course, I didn't know at the time that she would be an historic figure in American music. Those were fascinating days, ah, the days of our youth.

* *

Deflation has hit the world art market and hit it hard. In May 1990 a Japanese industrialist paid $160 million for two paintings bought in NYC, a Renoir and a Van Gogh. Those days are gone. This year the most expensive painting sold was a Degas sold for $9.7 million at auction at Christie's. But sales and profits at both Christie's and Sotheby's have gone into reverse. Sotheby's is now projecting a 50% drop in international sales and Christie's worldwide is expecting a sales drop of 50%. One reason -- the collapse of the Japanese market.

* *

Speaking of the Japanese market, the Nikkei recently broke below 22,000, its lowest level of the year. Japanese banks are allowed to include their stock holdings as part of bank assets, and as Japanese stocks decline, the pressure is on Japanese banks to raise liquidity. If the Nikkei continues on its bear market path, Japanese banks will be forced to sell assets, including US assets such as real estate and Treasury bonds.

* *

The economics of professional sports continue to fascinate me. Both CBS and ESPN have taken big losses in baseball, and the coming TV contracts are due to shrink, meaning less money for the team owners. This brings into question players' salaries. The following is from a book review in the August 18 *LA Times:* "In 1966 the salaries of all major players totaled $9.5 million, about what Roger Clemens and Tony Gwynn together make in 1991. Last year, when players won their arbitration cases, their average salaries increase was 141%. When the clubs beat the players, the players' average increase was still a thumping 110%. In 1990, the Brewers' Robin Yount became the first player to make a $3 million salary. In 1991, there are 32 ball players making $3 million . . . In 1941 the average major league salary was less than $10,000. DiMaggio was paid $35,000." Russell opinion: I think the pro stars should get ready for a big change. Salaries have gone up exponentially. Every market veteran knows what happens to rising exponential curves.

Miami Dolphin Dan Marino just signed a five-year contract paying him $25 million. That's really big money, substantially bigger than Joe Montana's $3.5 million a year. And of course, there's another big difference. Marino lives in Florida where there's no state income tax, while Montana lives in California where we are taxed silly. Well, at least there are no mosquitos in northern California, right Joe?

* *

There are now 700,000 practicing lawyers in the land. There are roughly 187 million new civil law suits added to the federal and state dockets every year. The direct and indirect cost of this litigation adds up to more than $300 billion a year. The cases are equal in number to one for every ten adults in the land. The US has 70% of all the lawyers in the world. I think the whole situation is getting a bit excessive, but I've got to be very careful, because my wife's a lawyer.

* *

The question is asked, why won't anyone run for public office in the US? Here are some reasons: (1) It's almost impossible to unseat an incumbent. (2) Candidates have to spend part of each day raising money. Many candidates go into debt raising enough money to run a campaign. (3) The ugliness of the TV age. Every aspect of a candidate's life is open to public inspection, and the slightest problem or infraction may be used as ammunition to be broadcasted to constituents. Everything in a candidate's life is fair game from a sexual tryst to the fact that the person smoked pot 20 years ago in college. This from a recent article from the *International Herald Tribune* on the subject: "Think of the traditional Republican recruit. An independent businessman with great wealth, or a community leader capping off a career. And then the party people say to him, 'See that gang of people with the clubs? They're going to beat your brains out for the next year. And then they'll start on your family.' No wonder they don't want to run."

* *

Here are some excerpts from a new book, "Euroquake," by Daniel Burstein. Burstein states that there are three forms of capitalism: the US, the Japanese and the German variety. "In another era, the American separation of government and business was both a glorious ideal and a workable system . . . Clinging to that outdated version today has become naive and nostalgic at best, downright suicidal at worst . . . The European Community's 1992 program will be a substantial success . . . It will surpass the US and become the largest single market in the world by the end of 1993 . . . German unification will prove to be one of the great economic success stories of modern times . . . Berlin will emerge as the most important city in Europe . . . An economic alliance will evolve between Europe and Japan . . . US companies with European operations will be good stock market plays . . . Hope for an US revival will have to wait at least until the 1996 elections . . . The English language will increasingly dominate the world."

* *

Europe's most powerful nation, Germany, is growing increasingly annoyed with the US' policy of easy money and softness on inflation. The fiercely independent Bundesbank's recent boosting of its discount rate was directly counter to the US' desire for lower world rates. Asia's most powerful nation, Japan, is increasingly willing to thwart US wishes. Even as the Bush administration has pushed Japan to provide more financial aid to developing nations and to serve as the locomotive for other industrialized countries, the administration has also resisted giving Japan a strong voice in international finance. The US has also taken a stand against Japanese military power. In a recent issue of *Foreign Policy*, Japanese journalist Kan Ito writes, "The American policy of keeping Japan militarily weak while pressuring Japan to pay more and more has built up suppressed anger and resentment among many Japanese politicians. They feel that the US is demanding burden-sharing without offering power-sharing and leadership-sharing in return. The Japanese feel treated as inferiors; they feel distrusted. They feel, in fact, more than a little insulted."

* *

Two years ago Ford bought Jaguar for an astounding $2.5 billion. I've owned three Jaguars, and they were beautiful cars, gorgeous designs, lovely interiors. But mechanically, Jags were primitive, a leftover of the '50s. Furthermore when founder Lyons died, I thought Jaguar's designing went to pot. Lyons (who began by making sidecars for motorcycles) was a designing genius. The E-Jags and XJ6 and the 12s were all fabulous, classic designs. Today, I can't tell a Jag from any other car. Ford paid an outrageous $2.5 billion for a company, a company that will lose about $100 million this year. For the first seven months of 1991 Jaguar's sales have dropped 42%. Furthermore, Jaguar is a company that has to be brought into the twentieth century. I think Ford way (and I mean WAY) overpaid for Jaguar, and I think Ford's going to regret that purchase if it doesn't already.

* *

Jim Williams was interviewed in *USA Today* (Aug. 20). *Williams Inference Service* sells information and opinions to corporate clients for $100,000 a year. Williams talks about the generations: "People born between 1901 and 1924 are the GI generation (Russell comment -- that's me). They build things, fight wars and are very civic-minded. They're leaders. Then there's the Silent Generation, born between 1925 and 1942. It's my generation (Williams is 62). These people are rich and got benefits from their parents, who built things. They don't take a stand on anything, and they agree with everybody. Then there's the famous boomers, born between 1943 and 1960. Boomers are very moral and very selfish. Their generation is going to outlaw a lot of things. The boomers are taking over. We're seeing a moral revolution. Question: You've talked for over a year now about the 'Batman theme,' cleaning up morals and the environment and all that stuff. What's the next theme shaping up to be? Answer: The Robin Hood theme. Batman was the move about cleaning up Gotham City. Now it's Robin Hood -- that means the baby boomers are going to steal from us, break the retirement programs and say, 'You're not entitled.' What that means for the market is slow erosion. A long bear market, not a crash."

* *

Strange, but that fits in with an item I just read in the excellent *Currency Bulletin* (14 Pall Mall, London, SWIY 5LU, England). "People look to the Depression of the 1930s for a precedent to what such a cyclical downturn might bring. But there may be a better parallel in the last two decades of the last century, in what was known in America as the Great Depression, lasting from the early 1880s to 1897. It followed the great revolution in transport brought about by the railways. There was no great Crash, as in 1929. It was just a long, long period of slack business, debt liquidation and falling prices, during which commentators agreed that there was a persistent over-supply of goods and a dogged lack of demand."

* *

Do you ever get depressed? You do, then I suggest that you subscribe to *Town & Country* magazine. Its high-gloss paper and fantasy jewelry, leather and watch ads alone are enough to make you feel better. This magazine is the bible of the rich and social. It's on a different planet. Everything is la de da in *Town & Country* -- gorgeous, thin wealthy women in $10,000 gowns, statesmen-like gentlemen in the latest dinner jackets, fabulous estates, marvelous living rooms. It's a great, wide, wonderful world we live in, and you can see it all in the *Town & Country* magazine, your entrance to the wonder world of multi-millionaires and billionaires.

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Here's a headline from the August 4 *NY Times*, and it applies to California as well. Both states are making it increasingly difficult

How Long Can New York Redistribute Wealth Before the Wealthy Leave?

By SAM ROBERTS

IN New York's City Hall last year, iconologists recorded a subtle shift by Mayor David N. Dinkins. The portrait of former Mayor Fiorello H. La Guardia, a demigod of progressive urban policy, had been

headed a city commission on tax policy. "State and local governments all over the country are beginning to bleed."

The hemorrhaging was hastened by the Reagan Administration's "new federalism," which shifted traditional national obligations to states and localities. Sena-

for business and high-income people to stay put. I know many people here in California who have either moved or are planning to get out. The trend is ominous, and it will continue to impact on the states' budgets and on their tax base (businesses and the wealthy leave, the poor and the welfare recipients continue to move in). The latest -- General Dynamics is consolidating and may very well exit from California. So far, in the past four years, Southern California has lost 60,000 aerospace jobs and the estimate is that another 160,000 will be lost over the next four years. Get this -- California's July tax collections dropped 3.4% below the same

month last year, and tax receipts have now dropped for seven consecutive months. For the fiscal year ending in June, California's tax receipts saw its first annual drop since the depression in 1937. I continue to believe that California is headed in the wrong direction. This state is going to face continued major financial problems in the years ahead.

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LOOKING AHEAD: My friend, Jim Grant (*Grant's Interest Rate Observer*, 233 B'way, NYC 10279) and I both share a rather cynical view of the trend of US finances. In his latest report, Jim Grant does a bit of extrapolating and forecasting.

Grant notes that "between 1981 and 1990 the gross federal debt grew at a compounded rate of 13.9%. For perspective, during the same period the population grew by 0.9% a year and the nominal GNP grew by 6.8% a year. Real, or inflation-adjusted, GNP grew by 3.5% a year (since the year the recession ended, 1982). Thus, by definition, the gross debt per working American rose sharply to $30,641 at this writing from $9,903 in 1981 or at a compound annual increase of about 12%. These are provocative numbers, and they may help to explain why the long-dated Treasury bond yields 8.25% in a recession."

Grant then speculates as to what the picture could look like nine years from now in the year 2000, assuming that the trend since 1981 continues to hold. The gross federal debt, growing at 13.9%, would be **$11.7 trillion** in the year 2000 vs. $3.6 trillion today. Assuming average interest rates of 6%, the annual interest cost to carry the federal debt in the year 2000 would approach **$447 billion** (that's equal to the government's entire receipts in 1978). By the year 2000, the nominal GNP would be around $10.2 trillion, but the gross public debt would be $11.7 trillion or **115% of GNP**.

Grant notes that in 1993 the government will have to raise some $2 trillion (to put this in perspective, in 1988 the government raised only $731 billion). In other words, the government will have to take in a massive amount of tax money compared with 1988 or even compared with this year.

In view of this, how are we doing now in tax receipts to the Treasury? Ominously, tax receipts from individuals for the first nine months of 1991 are lower than the same nine month period of 1990 -- and this after a major tax increase!

Looking ahead, the situation should become increasingly difficult. I've said this before, but I might as well repeat it (for the benefit of my Congressional readers). The magic of compounding can turn systematic savings into an eventual fortune. But compounding in reverse (i.e., debts being increased and compounded year after year) can turn a fortune into a bankruptcy.

Things change -- sinners can become saints, fat people can become thin, bear markets can reverse and become bull markets, politicians can become statesmen, and Congressmen can face facts. But if current trends in government finances continue, there are going to be some big surprises in the stock and bond markets. You can change a lot of things -- but nobody yet has been able to change the laws of compounding. It's worth thinking about.

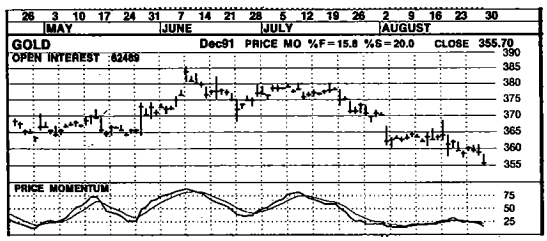
GOLD: At the seminar in Vancouver, I was talking to my old friend Ian McAvity (he's a Canadian). At one point Ian reached in his pocket and pulled out a few of the metal Canadian dollars. They are about the crudest, worst looking coins I've ever seen, and we both laughed as we examined them. Ian said, "Do you believe these damn things? They look like they've been stamped out of tin cans." I agreed. I replied, "Unbelievable, and to think that you can trade 360 of these pieces of junk for an ounce of real gold!" Then it struck me anew (because the Canadian dollar coins looked so bad) what a sham governments are pulling over our eyes. Imagine, stamping out this base-metal junk, announcing that it's legal tender, and having citizens act as if it's money.

Of course, these ugly pieces of metal are legal tender in Canada, just as our government-manufactured dollar bills are legal tender in the US. But with both the US and Canada producing literally carloads of junk currency, I continue to believe that it's wise to have some real, intrinsically valuable money in one's possession. And gold is the world's real money.

I believe that ultimately all truth emerges, whether that truth is the illegal manipulation of Treasury paper at Salomon Bros. or whether it's the rigging of the Japanese market or whether it's phoney "wealth-building" by Donald Trump. I put US currency in the same sham category. The US dollar is "money" by decree, issued by a profligate government. No currency can hold its value when its issuer is running debts of over one billion dollars a day. Truth and reality possess more power than all the politicians in Washington and the rest of the world combined. The truth of our fiat "money" will come out -- it's simply a matter of timing.

On August 30 London gold was fixed at 347.50, a new low for the move. The story was that traders were nervous about potential Soviet sales of gold. Gorbachev has stated that one of their first acts must be to make the ruble convertible. The most intelligent way of fostering faith in the ruble would be to back it with gold. But the US would surely object to that. What, a gold-backed ruble and a nothing-backed dollar? Alexander Hamilton would turn in his grave.

This chart from *Investor's Daily* shows gold banking down into its 350 support (Dec. contract) again. This is the area where support has come in previously.



LATE NOTES: I'm looking at the business page (Aug. 30) of the *NY Times* . The lead article states that "New-Home Sales Fell 8.5% in July. Unexpected plunge is a sign of consumers lack of confidence." Then on the same page another article headlines, "Fund Groups Having the Time of Their Life. With individual investors growing more and more confident about both the stock and bond markets, cash is pouring into many mutual funds at a record rate."

So consumers have little confidence in the economy -- yet they have unlimited confidence in the stock and bond markets? That's a schizophrenic split that can't last. Either consumers (whose buying makes up two-thirds of GNP) are going to become confident buyers again or stock prices are going to come down. The two can't go their separate ways for long.

Meanwhile, that divergence between the D-J Industrials and the D-J Transports (described on page 1) continues. In the past, persistent divergence between the the Dow and the Transports has indicated distribution. This is a strange market -- it's extremely overvalued, but the public is buying it (via the funds) as if there was no tomorrow.

Incidentally, the stock market does not like excesses. One excess I see is the mutual funds -- there are now an absurd 3,200 funds, far more than there are stocks on the NYSE. Evidently, no matter how they feel in other areas, people feel safe in mutual funds (after all, their money is in professional hands, so what can happen?).

And, of course, there is that other excess, debt. In his latest mailing, economist Ed Hyman (*International Strategy and Investment*) states, "In July, the Federal Deficit was $428 billion on a seasonally adjusted annual rate basis. We are raising our Deficit estimate for 1992 from $375 to $380 billion." History tells us that sooner or later the market washes away all excesses. Now that's a thought, isn't it?

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